S&P Global Ratings

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Summary:

East Bay Community Energy, California; Retail Electric

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ICR		
Long Term Rating	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' issuer credit rating (ICR) to East Bay Community Energy (EBCE), Calif. The outlook is stable.

At fiscal year-end 2021, EBCE had no debt outstanding.

Credit overview

EBCE, a community choice aggregator (CCA) that began serving electricity in 2018, has quickly gained more than half a million customer accounts and, we believe, has achieved credit supportive financial results while offering competitive rates. The CCA, formed to provide clean and affordable power and stimulate the local economy, is responsible for procuring a sufficient power supply for its customers' demands. EBCE uses the transmission and distribution assets of the service area's incumbent investor-owned utility, Pacific Gas and Electric Co. (PG&E; BB-/Negative), to deliver the electricity. Because the CCA provides retail electric service and is a public agency, S&P Global Ratings evaluates EBCE's creditworthiness under the scope of our municipal retail electric and gas utilities criteria.

The rating further reflects our view of EBCE's:

- Deep customer base of 640,000 accounts with residential customers responsible for almost half of EBCE's kilowatt-hour sales, enhancing revenue stability;
- Protective joint powers agreements with its member communities, requiring a departing member to provide six months' notice, receive EBCE board approval, and make the CCA whole for any costs incurred to serve that member signed prior to its departure, which we believe serves as a disincentive for a member to terminate its contract with EBCE;
- Diverse power supply arrangements with a variety of contract types, geographic locations, and storage capabilities (many of the supply contracts provide renewable power, which positions the CCA well for California's renewable portfolio standard as well as potential future federal carbon emission regulations);
- Solid financial performance including historical fixed-cost and imputed charge coverage (FCC) around 1.3x on a historical and projected basis and, at the end of fiscal 2021, considerable liquidity of more than 180 days, which we expect will increase in the coming years; and
- Limited direct exposure to wildfires through California's strict liability standard and inverse condemnation given the absence of CCA-owned generation, transmission, or distribution assets.

Partly offsetting the above strengths, in our view, are EBCE's:

- Direct retail competition with PG&E, which limits the CCA's rate-setting flexibility (EBCE has rate setting autonomy, but in its first few years of operations, the CCA has purposefully kept its standard offering slightly below the PG&E rate);
- Power procurement uncertainty as the CCA must balance its obligation to enter long-term contracts with a potentially volatile load profile given possible member community and/or individual customer exit from the CCA, as well as a need to balance its renewable mandates with the need for reliable baseload energy;
- Exposure to the power charge indifference adjustment (PCIA), which varies year to year and could pressure the CCA's competitiveness if costly enough; and
- High reliance on market purchases with the CCA planning to purchase more than a quarter of its electricity from the market in each of the next several years (although we recognize that the CCA's hedging practices considerably reduce EBCE's exposure to elevated market prices, with typically more than 80% of projected load hedged at the start of each month).

The stable outlook reflects our expectation that EBCE's rates will maintain competitive with PG&E, enabling the CCA to sustain its large customer base. We also believe that EBCE's significant unrestricted reserves will continue growing, providing flexibility to meet financial obligations.

Environmental, social, and governance

We believe EBCE's environmental risk exposure is low, based on its predominantly carbon-free resource portfolio. In 2020, the CCA's fuel mix of its standard offering was 40% renewable and less than 1% specified fossil fuel resources. EBCE plans for its fuel mix to be 100% carbon-free and a minimum of 65% from eligible renewables by 2030. However, as a practical matter, the intermittency of renewable resources might frustrate EBCE from achieving California's ambitious greenhouse gas emission goals in the absence of storage technology breakthroughs. We also note that EBCE has indirect exposure to wildfires that affect PG&E's transmission and distribution assets needed to serve the CCA's customers.

Regarding social factors, health and safety precautions that officials enacted in response to the COVID-19 pandemic resulted in EBCE's experiencing reduced weather-normalized electric sales in calendar 2020. The CCA has suspended its "Delinquent Accounts and Collections Policy" through the end of 2021. EBCE initially increased its uncollectables budget to 2.5% from 0.5%, but has since lowered the budget to 1%; the CCA expects to receive state funding to cover at least some of its arrearages. S&P Global Economics forecasts that U.S. GDP declined 3.4% in 2020 and estimates a rebound of 5.5% in 2021. (See "Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude," published Nov. 29, 2021, on RatingsDirect.) S&P Global Ratings believes uncertainty remains high, albeit moderating, about the evolution of the coronavirus pandemic and its economic effects.

We view EBCE's governance factors as credit-supportive, as they include robust joint powers agreements with members, full rate-setting autonomy, comprehensive policies and planning (including a risk management program with detailed hedging targets), and a sophisticated management team. The CCA produces detailed long-term financial forecasting and integrated resource plans, and participates in California utility proceedings. We also believe that EBCE performs appropriate due diligence when entering power supply contracts, including examining counterparties' financial well-being and requiring collateral postings. However, the potential for retail customer opt-out somewhat tempers our view of EBCE's governance factors.

Stable Outlook

Downside scenario

We could lower the rating if EBCE experiences increases in its power supply costs, which could either pressure the CCA's rate competitiveness and/or result in a reduction in EBCE's unrestricted reserves, depending on management's actions. Also, if any of the member communities leave the CCA, EBCE could be forced to sell surplus contracted power to the market. In the event market prices decrease to levels significantly below those of the CCA's portfolio, EBCE could face significant financial pressure, which, in turn, could lead us to lower the rating.

Upside scenario

We do not expect to raise the rating in the next two years, given the inherent risks posed by the direct competition for EBCE's retail customer base. However, if the CCA's operations result in significant competitive advantages relative to the incumbent investor-owned utility over the next several years, while EBCE's FCC and liquidity strengthen, we could raise the rating.

Credit Opinion

In our view, EBCE's service area has favorable economic fundamentals. The CCA serves 15 member communities, all but one in Alameda County. Median household effective buying income in the county, which is part of the board and diverse San Francisco Bay Area economy, is 153% of the national level. We also note no customer concentration in the service area with the top 10 customers accounting for only 2.9% of sales and the top customer 0.4%.

EBCE has a large number of customer accounts, which we believe provides the CCA with considerable economies of scale. EBCE has grown quickly in the few years in which it has operated because all the accounts in the member communities that PG&E previously served were automatically switched to the CCA when that member community joined EBCE. Customers have the option to opt out of EBCE service and return to PG&E; there is no penalty to return to PG&E if undertaken within a set timeframe. However, the CCA's opt-out rate has been less than 5%, which we view as low and demonstrating EBCE's value proposition.

Compared with the member communities, individual customers have a much lower barrier to leave the CCA, which, in our view, constrains EBCE's rate-raising flexibility. In its first few years of operations, the CCA has offered customers a rate slightly lower than the customers would have received from PG&E, while still increasing unrestricted reserves. We believe EBCE's lower rate offering is a significant reason why the CCA's opt-out rates have been minimal. If EBCE's rates became more expensive than PG&E, we think more customers would opt-out and return to PG&E. Because of this, we think that EBCE's rate-setting flexibility is somewhat limited and especially so for as long as the CCA intends to set rates relative to the PG&E rate.

One area where EBCE has minimal control over its rates is the PCIA, which reflects the costs that PG&E incurred to procure power at above-market costs for these customers when PG&E still served them. The PCIA will decline in fiscal

2022 relative to its 2021 level. In addition, over the longer term, the PCIA will become less meaningful as power supply contracts that PG&E signed for its former customers expire.

We believe that EBCE's FCC demonstrates healthy cost recovery, averaging 1.3x over the past three years. FCC is an S&P Global Ratings-calculated metric that treats a share of the CCA's purchased power expenses as debtlike instead of an operating expense. FCC was closer to 1.1x in fiscal 2021 as the COVID-19 pandemic reduced sales and the PCIA was elevated. Although EBCE has a short operating history, we project the CCA's FCC will rebound to near 1.3x over the next several years.

The utility has considerable liquidity to meet operational and financial challenges. Unrestricted cash and cash equivalents, including undrawn amounts on a committed line of credit, exceeded $206 million, or more than half a year of operating expenses, at fiscal year-end 2021. We believe EBCE's risks associated with its core business model--specifically the potential for customer exodus, rate-setting constraints, and substantial purchases of market electricity--necessitate enhanced reserves. The CCA has a formal liquidity target of 50% of operating expenses and expects to have reserves, including a committed line of credit, that reach 75% of operating expenses in the next five years, which we view as a credit positive.

EBCE has no debt outstanding, which we view favorably. The CCA's management reports that EBCE could incur indebtedness if the debt and associated assets were economical and fit within its risk management plan's tolerances. We note that if the CCA acquires direct or indirect ownership of capital assets, this could have implications for EBCE's exposure to California's strict liability standard and inverse condemnation.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020